ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
	)	

TO: The Commission

PETITION FOR RECONSIDERATION

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July 17, 1997

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SUMMARY

The Commission's recent Universal Service Order rewrites Section 254 to dilute the rural safeguards it was intended to implement. Specifically, the Order: (a) recasts Section 254 from a safety net to a pro-competitive weapon by superimposing a supplemental "competitive neutrality" principle over the express Universal Service principles adopted by Congress; (b) reduces existing Universal Service support abruptly and substantially for rural telephone companies during a transition period; and (c) adopts a still-largely-undefined future rural Universal Service "support mechanism" designed to slash support for rural telephone companies.

The Order's emphasis upon the extraneous "competitive neutrality" principle disregards the express "rural/urban comparability," "quality and affordable service," and "sufficient support" principles inserted by Congress in Section 254(b), as well as numerous contemporary statements by legislators regarding the purpose of Section 254. The Order uses "competitive neutrality," inter alia, to limit "core services" to those available from potential wireless competitors, without properly considering the needs of rural residents for services comparable to those available in urban areas (e.g., equal access to toll services). Moreover, it interprets the principle in a non-neutral manner to benefit potential competitors at the expense of existing rural telephone companies (e.g., portable per-line support during transition period).

The Commission's transition mechanism fails to furnish "sufficient" support for rural telephone companies. First, it imposes, without reasoned explanation, a cap on Corporate Operations Expense that abruptly and substantially cuts the support of many small carriers at the very time when they critically need the subject services to respond to new regulatory schemes. Second, the Order imposes a new two-year lag upon weighted DEM and LTS support at a time when substantial switch upgrades are necessary to accommodate federal dialing parity and number portability requirements. Third, the Order continues the "interim" cap on the existing USF, and raises questions whether this cap will effectively eliminate the weighted DEM

and LTS support programs being transferred into the current USF. Fourth, the Order disregards the interests of rural residents long neglected by larger LECs, by arbitrarily freezing USF support in a manner designed to discourage small carriers from purchasing and upgrading such exchanges.

The future mechanism adopted by the Order is transparently designed to cut to the bone Universal Service support for rural telephone companies in violation of the Section 254(b)(5) "sufficiency" principle. The defects of this mechanism include: (a) mandate of an indeterminate forward-looking cost model, particularly when current versions are known to contain substantial defects; (b) use of an urban-dominated national revenue benchmark designed to reflect revenues substantially larger than those actually realized by rural carriers; and (c) reduction of the portion of rural support provided by the federal mechanism to 25 percent.

Finally, the Order's mangled definition of "owned facilities" allows all but "pure resellers" to qualify for Universal Service support, contrary to the intent of Congress.

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PETITION FOR RECONSIDERATION

The Western Alliance, pursuant to 47 U.S.C § 405 and 47 C.F.R. § 1.429, petitions for reconsideration of various portions of the Commission's recent Universal Service order[1] relating to rural areas. It seeks reconsideration of the Commission's (a) rewriting of the nature and purpose of Section 254's rural support mechanisms by superimposing its own supplemental "competitive" principle over and above the rural principles specified by Congress; (b) reducing during a transition period of the current Universal Service support furnished to rural telephone companies [via limitation of Corporate Operations Expenses; introduction of a two-year lag for weighted Dial Equipment Minutes (DEM) support and Long Term Support (LTS); continuation of the "interim" indexed Universal Service Fund (USF) cap; and limitation or denial of support for acquisition and upgrade of long-neglected rural exchanges of larger carriers]; (c) slashing of long-term Universal Service support for rural telephone companies [by adopting a still-indeterminate forward-looking economic cost proxy model and nationwide revenue benchmark designed to curtail support, and then further cutting the federal portion by 75 percent]; and (d) diluting the support available for carriers willing to construct and maintain rural telecommunications infrastructure by distorting the Section 214(e) eligibility requirements to allow everyone but a "pure reseller" to qualify for support.

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[1] Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC 97-157 (rel. May 8, 1997) (summarized at 62 FR 32862 (June 17, 1997)) ["USF Order"].

THE WESTERN ALLIANCE

The Western Alliance previously has submitted comments in response to the Commission's Notice of Proposed Rulemaking[2] and the Joint Board's Recommended Decision[3] in this docket. It is a consortium of the Western Rural Telephone Association (WRTA) and the Rocky Mountain Telecommunications Association (RMTA). These two trade associations represent nearly 250 small local exchange telephone carriers (LECs) serving rural areas west of the Mississippi River, including Alaska, Hawaii and insular territories.

Western Alliance members include commercial telephone companies (many family-owned) and cooperatives. They serve sparsely populated, rural areas which the former Bell System and other large carriers ignored or declined to serve during the initial construction and development of the U.S. telephone network. Most members serve less than 3,000 access lines, and have relatively small revenue streams. At the same time, Western Alliance members incur much higher costs (on a per-subscriber basis) than larger carriers. They frequently must install lengthy loops (sometimes as much as 40-to-50 miles) over rough and unpopulated terrain and, on average, serve only 500 subscribers per exchange (about 3.24 per route-mile).

Because of these high-cost, low-density factors, Western Alliance members have relied upon federal Universal Service support during the past decade to meet a critical portion of their service costs and obligations (for example, "carrier of last resort" requirements) while providing quality local service at reasonable and affordable rates. Their continued ability to do so is vitally affected by the USF Order.

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[2] Federal State Joint Board on Universal Service, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order Establishing a Joint Board, FCC 96-93 (rel. Mar. 8, 1996).

[3] Federal State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, 12 FCC Rcd 87 (1996)

ARGUMENTS

I. THE COMMISSION'S PREDOMINANT RELIANCE UPON ITS SUPPLEMENTAL "COMPETITIVE NEUTRALITY" PRINCIPLE VIOLATES THE LETTER AND SPIRIT OF SECTION 254

Administrative agencies may not adopt policies that directly conflict with their governing statutes. Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116, 134-35 (1990). They must give effect to the intent of Congress when it has spoken to a precise question. Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984). Moreover, agency interpretation of statutes is not entitled to judicial deference when it is contrary to congressional intent or goes beyond the meaning the statutes can bear. Id. at 843 n.9; MCI Telecomms. Corp. v. AT&T, 512 U.S. 218 (1994), 1994 LEXIS 4639, at *19.

The USF Order violates these standards by adding its own new "competitive neutrality" principle to the six Universal Service principles expressly adopted by Congress in Section 254(b), 47 U.S.C. § 254(b), and then employing this supplemental principle to recast and curtail the rural support mechanism in a manner directly contrary to the intent of Congress. The Commission needs to reconsider this error, and to reformulate its rural mechanism in accordance with the express Section 254(b) principles of "quality services at affordable rates," "urban/rural comparability," and "specificity, predictability and sufficiency."

Background. Section 254 was intended to preserve and advance the fundamental policy goal of Universal Service by ensuring that rural areas, low-income consumers, schools, libraries and rural health care providers are not disregarded or shoved aside in the rush for profits in newly competitive telecommunications markets. It is not subservient to the portions of the Telecommunications Act of 1996 [hereinafter 1996 Act] dealing with competition and deregulation. Rather, it constitutes a separate and independent policy framework resulting from Congressional recognition that competition may not bring adequate facilities and services within the foreseeable future to those disadvantaged by geography and economics.

With regard to rural areas, Congress declared in Section 254(b) that Universal Service

mechanisms be governed by the following principles: (1) availability of quality services at just, reasonable and affordable rates, 47 U.S.C. § 254(b)(1); (b) access to advanced telecommunications and information services in all regions of the nation, id. § 254(b)(2); (c) access by rural customers to telecommunications and information services (including interexchange services and advanced services) reasonably comparable to those provided in urban areas at rates reasonably comparable to rates charged for similar services in urban areas, id. § 254(b)(3), and; (d) use of specific, predictable and sufficient Universal Service support mechanisms, id. § 254(b)(5).

The legislative history of the 1996 Act emphasizes the role of Section 254 as a safeguard against competitive market failures in rural areas. Relevant statements include:

1. Sen. Pressler: "[T]his bill is also responsibly deregulatory. When it comes to maintaining universal access to telecommunications services, for instance, it does that. It establishes a process that will make sure that rural and small-town America doesn't get left in the lurch." 141 Cong. Rec. S7888-89 (June 8, 1995).

2. Sen. Hollings: "Special provisions in the legislation address universal service in rural areas to guarantee that harm to universal service is avoided there." 142 Cong. Rec. S688 (Feb. 1, 1996).

3. Sen. Daschle: "While legislation focuses on competition and deregulation, the bill before us also contains essential rural safeguards. It would create a Federal-State Joint Board to oversee the continuing issue of rural service and to monitor and help evolve a definition of Universal Service that makes sense for the present day and for the kinds of services that will be coming on-line." 141 Cong. Rec. S8478 (June 15, 1995).

4. Sen. Dorgan: "Universal service has been a success because policymakers had the foresight to understand that market forces, left to their own devices, would not serve every American. . . ." 141 Cong. Rec. S4210 (March 16, 1995). "Some have argued in favor of reducing, and in some cases, eliminating, the level of universal service support. This is flagrantly inconsistent with this Nation's 60-plus year commitment to universal service for all Americans. Congress and the administration alike have set many ambitious goals for the telecommunications industry -- goals that can be met only if we are willing to make a renewed commitment to support, not abandon, the policy of universal service." Id. at S4211.

5. Sen. Harkin: "[W]e must also recognize that telecommunications competition is limited in some areas, especially in many rural areas. . . . Without universal service protections, advanced telecommunications will blow right by rural America creating a society of information haves and have nots." 142 Cong. Rec. S713 (Feb. 1, 1996).

6. Rep. Bonilla: "I believe that this bill gives proper consideration to providing protection for rural communities where our consumers are spread thinner and the cost for providing

services can be much higher. I'm pleased that this bill recognizes that our rural communities operate under unique service conditions which must be addressed. . . . H.R. 1555 contains important protection for these communities, including universal service principles that provide for comparable rural/ urban rates and service . . . ." 141 Cong. Rec. H8497 (Aug. 4, 1995).

7. Rep. Orton: "[I] would like to express my support for the strong provisions in this bill which protect rural America. . . . Fortunately, the stronger Senate provision, fully protecting universal service, prevailed." 142 Cong. Rec. H1173 (Feb. 1, 1996).

In other words, Congress recognized that telecommunications competition may have the same adverse impact upon rural America as airline deregulation. See 141 Cong. Rec. S7947-51 (June 8, 1995) (statement of Sen. Dorgan on impact of airline deregulation in rural America). Whereas competition may develop and flourish in urban and suburban areas, investment and service in rural areas will decline without sufficient Universal Service support.

USF Order. The USF Order disregarded the statute and Congressional statements by adding "competitive neutrality" as a supplemental principle. USF Order para. 47. It asserted this extraneous principle was "consistent with congressional intent and necessary to promote 'a pro-competitive, de-regulatory national policy framework.'" Id. para. 48. It defined it to include "technical neutrality" so as to "foster the development of competition and benefit certain providers, including wireless, cable, and small businesses, that [otherwise] may have been excluded from participation in universal service mechanisms [emphasis added]." Id. para. 49.

The USF Order rejected arguments of "commenters" that Congress had recognized that competition may not serve the public interest in rural areas, and that the advancement of Universal Service in rural areas was more important. It asserted that these "commenters" present a "false choice between competition and universal service," and stated its expectation that competitive neutrality "will promote emerging technologies that, over time, may provide competitive alternatives in rural, insular, and high cost areas and thereby benefit rural customers." Id. para. 50.

The USF Order also refused to find any evidence in the record or legislative history that Congress intended to exclude competitive neutrality as an additional principle, stating that

"promotion of competition is an underlying goal of the 1996 Act." Id. para. 51. Finally, the USF Order declared that its Universal Service policies "should strike a fair and reasonable balance" among the express Section 254(b) principles and its supplemental "competitive neutrality" principle, and that "promotion of any one goal or principle should be tempered by a commitment to ensuring the advancement of each of the [other] principles" Id. para. 52.

Congressional intent. As detailed above, it was not mere "commenters" who asserted the intent of Section 254 as a safeguard for rural areas and others likely to be bypassed or injured by competition, but rather many of the very Senators and Representatives who drafted and passed the 1996 Act. The quoted Congressional statements leave no doubt that Universal Service is a separate and independent legislative mandate designed to alleviate the shortcomings of competition, and not a subservient element of the 1996 Act's pro-competitive provisions. Moreover, the language of Section 254 plainly indicates that Congress did not intend "competitive neutrality" or the "promotion of competition" (at the expense of existing rural telephone companies) to be one of the fundamental principles of Universal Service. Congress mentioned "competitive neutrality" only one time in Section 254 -- in Section 254(h)(2), where it expressly required the Commission to establish "competitively neutral" rules regarding access by classrooms, health care providers and libraries to advanced telecommunications and information services. If Congress had wanted "competitive neutrality" to be a (or the) fundamental Section 254(b) principle, it would have said so expressly.

Predominant reliance upon "competitive neutrality". Even if the Commission may add a "competitive neutrality" principle, it lacks authority to make it the predominant criterion regarding rural Universal Service support and thus virtually rewriting the Congressionally-specified principles out of the Act. Yet, this is exactly what the USF Order has done.

For example, the USF Order relies upon "competitive neutrality" rather than "urban/rural comparability" as its primary factor for defining the "core" services that initially will receive support in rural areas. The most egregious instance of this is its refusal to include

"equal access to interexchange service" (i.e., "1+" presubscription to toll service) as a core service solely because wireless carriers currently are not required to provide the service (although they may do so voluntarily). USF Order paras. 78-79. This ruling grossly violates Section 254(b)(3) by placing the interests of potential wireless competitors over the needs of rural residents[4] for a service that is readily available in virtually all urban areas.

Likewise, the USF Order disregards Section 254(b)(1) by refusing to adopt federal minimum service quality standards, and then interjects its "competitive neutrality" principle to limit the service quality standards which states may adopt. Id. paras. 98, 101. Again, this improperly sacrifices the service quality needs of rural residents in favor of the interests of potential competitors.

Pro-competitor slant. Finally, the USF Order interprets "competitive neutrality" in a manner designed to "benefit certain providers," id. para. 49, and to "promote competition," id. para. 51, at the expense of rural telephone companies. The prime example of this is the Commission's decision to give potential competitors the same per-line Universal Service support as rural telephone companies (even if their actual costs are considerably lower) in order to "aid the entry of competition in rural study areas." Id. paras. 311-12. This approach will not ensure quality, comparable, affordable or sufficient service in rural areas. Rather, it will weaken the rural telephone companies "who have taken the risks and made the investments to extend . . . phone service to smaller rural communities," see 141 Cong. Rec. S8478 (June 15, 1995) (Sen. Daschle), by promoting competition not warranted by the normal working of market forces.

Conclusion. The Commission should reconsider and reject its unauthorized rewrite of Section 254. It should jettison its efforts to remake Universal Service into another tool to promote competition and potential competitors, and employ the express principles of Section

[4] Toll service is often more important to rural residents and businesses than to their urban/suburban counterparts because they must make far more frequent toll calls to reach families, friends, government agencies, health care providers, vendors, and so forth.

254(b) to redevelop the rural support mechanism envisioned by Congress.

II. THE COMMISSION'S TRANSITION MECHANISM FOR RURAL TELEPHONE COMPANIES VIOLATES THE "SUFFICIENCY" REQUIREMENT BY CUTTING OR LIMITING NEEDED SUPPORT.

On June 3, 1997, Chairman Hundt appeared before the Senate Subcommittee on Communications, and declared that the USF Order was "welcome news" for the small LECs which comprise "the backbone of telephone service in rural America."[5] He stated:

> First, we did not lower the current level of universal service support provided to small LECs. They will not lose the amounts they currently receive from DEM weighting, long term support or from the existing high cost fund, and universal service support will continue to grow to reflect new investment. Id.

Unfortunately, many small LECs will not be kept whole, but rather will suffer substantial losses or limitations of Universal Service support during the transition period. This curtailment of support results from: (a) the cap on Corporate Operations Expense; (b) the lags on weighted DEM and LTS support arising from their transfer to the current USF; (c) the continuation of the indexed cap on the USF; and (d) the limitation on USF support for acquired exchanges. These decreases and limitations violate the express Section 254(b)(5) principle that Universal Service support be sufficient.

A. The Corporate Operations Expense Cap Will Slash Existing Support for Many Small LECs

Corporate Operations Expense (Accounts 6710 and 6720) has long been deemed a cost inherent in providing local exchange and exchange access services, and has been supported through the existing federal USF pursuant to the recommendation of the Federal-State Joint Board in CC Docket No. 80-286.[6] These expenses -- which include executive compensation,

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[5] Statement of Reed E. Hundt on the FCC's Plan for Implementing Universal Service, before the Subcommittee on Communications. Committee on Commerce, Science and Transportation (June 3, 1997) at 3.

[6] Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Recommended Decision And Order, 5 FCC Rcd 7578, 7579 (1990); Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Report And Order, 6 FCC Rcd 2936 (1991).

legal and consultant fees, and other administrative costs -- have become even more essential during the last eighteen months due to the numerous and complex federal and state proceedings, orders and regulations which small LECs must monitor and analyze and with which they must comply.

The Joint Board in this proceeding made no recommendation regarding changes in the separations treatment or recovery of Corporate Operations Expense. Nevertheless, the Commission has now determined unilaterally that these expenses "do not appear to be costs inherent in providing telecommunications services, but rather may result from managerial priorities and discretionary spending." Id. para. 283. This assertion is advanced as a point of agreement with certain commenters, and is unaccompanied by any reasoned explanation as to why such necessary and long-supported expenses are now merely discretionary. It violates the established principle that "an agency changing its course must supply reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored." Greater Boston Television Corp. v. FCC, 444 F.2d 841, 852 (D.C. Cir. 1970).

The USF Order proceeded to implement this unexplained reversal of policy by limiting future federal support for Corporate Operations Expense to an arbitrarily selected "115 percent" of a projected per-line amount determined via a "formula" derived from a Commission staff study and regression analysis of certain 1995 National Exchange Carrier Association (NECA) data. Id. para. 284. The USF Order contained no discussion or reasoned explanation: (a) how or why the 115 percent ceiling was selected; (b) why a regression analysis using a spline function technique was accurate and appropriate; or (c) how or why the 1995 NECA data was representative.

The USF Order's initial "formula" would have reduced transitional USF support for over 140 small LECs by more than $100,000 per year. However, the Commission has already determined that this initial formula was flawed, and has revised it on its own motion. See

Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Order On Reconsideration, FCC 97-246 (rel. July 10, 1997) ["USF Recon Order"].

The Western Alliance has not yet had an adequate opportunity to analyze the revised Corporate Operations Expense limitation formula. However, review of Figure 1 of the USF Recon Order indicates that the Commission's regression line for per-loop Corporate Operations Expense: (a) fits the data for LECs with over 15,000 loops almost perfectly; (b) shows significantly more variability with respect to the data for LECs with 5,000 to 15,000 loops; and (c) shows wide variability with respect to LECs with less than 5,000 loops. This indicates that scores of the very smallest LECs will continue to suffer abrupt and substantial losses of essential Universal Service support under the revised formula during the so-called "transition period."

Figure 1 of the USF Recon Order demonstrates the futility and unfairness of Commission attempts to impose proxies like regression formulas upon small LECs. The facilities and cost structures of small LECs have not developed according to a common Bell System or other large LEC model. Rather, they have evolved wholly separately and independently as responses by different managements at different times to the unique conditions of different geographic and customer environments, using different equipment and network designs. Because of their widely varying circumstances, there is no manageable set of variables which can accurately and equitably determine "reasonable" Corporate Operations Expense or any other cost for small LECs. Put another way, the location of a particular small LEC's data point above or below the Commission's Figure 1 regression line is a function of its own specific history and environment, and indicates nothing regarding the "reasonableness" of such expenses. The use of such an irrelevant formula or regression model to cut the Universal Service support of many small LECs during the "transition" period is wholly inimical to the "specific, predictable and sufficient" principle of Section 254(b)(5).

B. The Transfer Of Weighted DEM And LTS to the USF Appears to Create A Two-Year Lag In Receipt of Such Support

At present, weighted DEM and LTS support are recovered on a current basis from interstate access charges, while USF is recovered on the basis of loop costs incurred two years previously. The USF Order's transfer of weighted DEM and LTS to the USF creates a new two-year lag for weighted DEM and LTS support. Id. paras. 303-04. It offers no explanation why this new lag is reasonable or necessary, particularly in light of its asserted intent to maintain the status quo for small LECS during the transition period.

Given the well-recognized time value of money, the new lags constitute a decrease in Universal Service support that will adversely impact the cash flow of small LECs, particularly those required to upgrade their switches or switching software to comply with dialing parity, caller ID and other Commission-imposed requirements. These lags violate the "sufficient" principle of Section 254(b)(5), and should be eliminated to restore the current DEM and LTS recovery timetables during the transition period.

C. Continuation of the Indexed Cap Violates the Sufficiency Principle

The USF Order extends the indexed cap on USF support adopted by the Commission in 1993[7] for the duration of the transition period. Id. para. 302. Given that the capped maximum USF was reached for the first time during the first quarter of 1997, see NECA Tariff 5 Transmittal No. 759 (June 16, 1997), continuation of the cap means that infrastructure upgrades and natural disasters which increase the costs of some LECs heretofore will reduce the proportion of applicable USF support recovered by all eligible recipients.

At the time the indexed cap was adopted, there was no statutory requirement that Universal Service support be "sufficient." However, the adoption of Sections 254(b)(5) and 254(e) prohibits arbitrary reduction of an eligible carrier's Universal Service support below the amount deemed "sufficient" under the Commission's rules. Therefore, continuation of the

[7] Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Report And Order, 9 FCC Rcd 303 (1993).

indexed cap after the effective dates of Sections 254(b)(5) and 254(e) is unlawful.

In addition, the reaching of the capped maximum USF during the first quarter of 1997 raises questions whether small LECs will be able to recover any of the weighted DEM and LTS support being transferred to the USF as of January 1, 1998. If the existing USF cap is not increased to accommodate transfer of DEM and LTS support from the access system into the USF, the effect will be the same as pouring additional liquid into a filled cup. Yet, whereas the USF Order expressly addresses the need to recalculate the USF cap as of January 1, 1999 when non-rural LECs will no longer receive support under the existing mechanisms, id. para. 302, it does not mention any plans to recalculate the cap as of January 1, 1998 to accommodate the transfer of weighted DEM and LTS support. The Commission needs to clarify that this omission is unintentional, and that it does not intend for existing DEM and LTS support to be virtually eliminated by the indexed USF cap.

D. Limitation of Support for Newly Purchased Exchanges is Unreasonable and Unlawful

The USF Order limits Universal Service support for newly-purchased, high-cost exchanges during the transition period to the amount of per-line support received by the seller prior to sale. USF Order para. 308. It bases this limitation upon the erroneous and wholly unsubstantiated "conclusion" that potential Universal Service support payments may influence unduly a carrier's decision to purchase exchanges from other carriers. Id.

Even assuming that the USF Order's attempts to rewrite Section 254 did not raise serious concerns regarding the future availability and amount of Universal Service support, there is simply no truth to the canard that small LECs have invested millions of dollars to purchase exchanges, and additional millions to upgrade them, for the primary purpose of increasing USF support. In reality, USF support is a minor consideration in the planning and evaluation of exchange acquisitions, and becomes significant only where the Commission's study area waiver process threatens to delay closing or to reduce the USF support previously received by the buyer for its pre-existing exchanges. See GTE Midwest Inc., Modern Telecomms. Co. and

Northeast Mo. Rural Tel. Co., AAD Docket No. 95-63, Memorandum Opinion and Order, DA 96-616 (rel. Apr. 22, 1996)(requirement for consolidation of acquired exchanges with existing exchanges reduced buyer's prior USF support by an estimated $250,000-to-$350,000 annually).

Contrary to the USF Order's theory, exchange purchases are undertaken for legitimate business reasons, such as expansion into neighboring markets and realization of increased economies of scale. Because small, local LECs have a record of providing quality and affordable service to rural communities, sales of rural exchanges normally have the strong support of local governments and their citizens. In fact, the Commission's study area waiver files are replete with examples of small LECs acquiring and upgrading rural exchanges long neglected by their larger counterparts. See, e.g., Union Tel. Co. and US WEST Communications, Inc., AAD Docket No. 96-120, Memorandum Opinion and Order, DA 97-269 (Feb. 6, 1997)(upgrade to digital loop carrier, install new cable, replace aerial wire); Pend Oreille Tel. Co. and GTE Northwest, Inc., AAD Docket No. 96-35, Memorandum Opinion and Order, DA 97-67 (Jan. 10, 1996)(upgrade to fiber, offer single party service, purchase CLASS capable digital switch); Accipiter Communications, Inc. and US WEST Communications, Inc., AAD Docket No. 96-35, Memorandum Opinion and Order, DA 96-1883 (Nov. 14, 1996)(install fiber, digital switch, extend service to unserved areas). The USF Order disregards these real and substantial service benefits provided to rural communities and their residents in its misplaced zeal to prevent purely mythical "USF-based" transactions.

The USF Order's limitation of Universal Service support for newly acquired exchanges serves no purpose related to section 254, and actually frustrates the Section 254(b)(5) requirement that support be "sufficient." It stands as a barrier to the goal of advancing Universal Service in general, and the principle of providing advanced services in particular. The Commission should reconsider and eliminate this unnecessary and counter-productive rule.

E. Conclusion

The Commission's transition mechanism for rural telephone companies violates the

principle that support should be sufficient, as well as the precedent and promise that "transition periods" maintain existing revenue and support flows without abrupt or substantial decreases. The Commission has reduced support for corporate operations expenses, has limited support for new exchanges, has extended the "interim" cap to the point that it has diminished available support, and has introduced a delay in the accrual of LTS and weighted DEM support. Taken together, these decisions will reduce Universal Service support to levels that will negatively affect the quality of service unless rates are raised to unaffordable levels. The Commission should reconsider these decisions to assure that Universal Service support remain sufficient.

III. THE COMMISSION'S FUTURE MECHANISM FOR RURAL TELEPHONE COMPANIES IS INSUFFICIENT AND OTHERWISE UNLAWFUL

The USF Order's long-term rural mechanism is transparently designed to cut to the bone the future Universal Service support to be furnished to rural America. The mandating of a still-indeterminate forward-looking economic cost model for the calculation of support in a declining cost industry is contrived to slash such support from the outset. The employment of a nationwide average revenue benchmark (dominated by higher urban and suburban customers) guarantees that rural support will be further reduced on the basis of estimated revenues significantly greater than those realized by rural carriers. Finally, the Commission applies its coup-de-grace by chopping the portion of rural support to be provided by the federal mechanism to 25 percent of this diminished base.

If the Commission is trying to discourage rural telephone companies from making further investments in infrastructure and service, it cannot have done a better job. The Western Alliance simply does not understand why the Commission is trying so hard to curb needed rural support programs with proven records of success, particularly at a time when it is throwing billions of dollars (with year-to-year carry forwards for unused funds) at schools, libraries and health care providers.

A. The Commission Should Reconsider Its Decision to Mandate Nonexistent And Ruinous Forward-Looking Economic Cost Models for Rural Carriers

The USF Order concedes that the forward-looking economic cost (FLEC) models on which thousands of hours of work have been expended during recent years are not dependable and cannot be used as the basis for calculating Universal Service support for any carrier. USF Order paras. 244-45. It characterizes these models as "imprecise," having "not provided dependable cost information" despite "significant and sustained efforts" and exhibiting "significant unresolved problems." Id. paras. 216, 244. In particular, it acknowledges that these models are inadequate for calculation of Universal Service support for rural telephone companies, and that they could significantly change the amount of support rural carriers receive. Id. paras. 252-53, 293-94.

Notwithstanding this lack of success in developing a workable FLEC model, the USF Order determines that some sort of hitherto-unidentified FLEC model can be developed for rural telephone companies and mandates the use of such nonexistent "model" by a date to be specified later. Id. This is the equivalent of finding that "if pigs had wings, they could fly," and then requiring that pigs be herded solely via helicopter as of some future date.

Predictability and Sufficiency. The USF Order pays lip service to Section 254(b)(5) by concluding that the future FLEC "model" will be "specific, predictable and sufficient." Id. para 293. It offers no support for its conclusion other than the hope that someone, someday will accomplish what nobody has yet been able to do.

The basic elements of a FLEC model -- that the assumed technology be least-cost and most efficient, and that the time period be long enough that all costs may be treated as variable and avoidable, id. para. 250 -- guarantee that it will not be specific, predictable or sufficient in a telecommunications industry characterized by declining equipment prices and rapidly changing technology. How can a rational LEC invest $1 million in a plant or switch upgrade, when it is possible that the Commission or a state commission may rule long before the investment is recovered that intervening changes have reduced the FLEC of such investment

to only $500 thousand so that it can only recover half of its investment? The subjectivity of the technology and time horizons mean that interested parties can develop widely different FLEC estimates for the same investments or facilities, and that FLEC determinations will become political issues resolved on the basis of power rather than objective and verifiable factors.

In short, the future FLEC approach adopted by the USF Order is anything but predictable, and promises to chill rural infrastructure development as a direct result. Moreover, the FLEC approach will not yield "sufficient" support and will produce unrecovered legacy costs, due to the inherent bias against recovering full costs which the Commission knows is characteristic of this pricing methodology. See Access Charge Reform, CC Docket No. 96-262, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, FCC 96-488, paras. 249 - 255 (rel. Dec. 24, 1996)(discussing differences between embedded and forward-looking costs). The Commission has noted on more than one occasion that forward-looking pricing may create shortfalls (or "residuals") as a consequence of disregarding embedded investment costs. See, e.g., Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, FCC 96-325 para. 707 (rel. Aug. 8, 1996).

The Western Alliance previously submitted information herein that the transition period recommended by the Joint Board would result in a $2.6 million shortfall. USF Order para. 230 n.592. Notwithstanding the Commission's denial of such claims, id., such shortfalls will result in unconstitutional "takings" of property without just compensation under the Fifth and Fourteenth Amendments to the U.S. Constitution. And, since the non-recovery of embedded costs appears to be a linch-pin of the Commission's use of the FLEC approach, it should reconsider such pricing for Universal Service support purposes as statutorily insufficient.

The Adoption of Forward Looking Pricing is Arbitrary and Capricious. It is well settled that "arbitrary and capricious" action entails a lack of rationality in an agency's decision

making, Columbia Broad. Sys., Inc. v. FCC, 454 F.2d 1018, 1028 (D.C. Cir. 1971). In Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402 (1971), the Supreme Court held that a court considering whether an agency's decision was arbitrary and capricious must determine "whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment. Id. at 416. Later, in Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29 (1983), the Supreme Court reiterated that an agency is charged under the "arbitrary and capricious" standard with the duty of examining the relevant data and articulating a satisfactory explanation for its action, including a rational connection between the facts found and the choice made. It stated that an agency would be found to have acted in an "arbitrary and capricious" manner if it "entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." Id. at 43. See also Wold Communications, Inc. v. FCC, 735 F.2d 1465, 1476 (D.C. Cir. 1984)(proper inquiry under the arbitrary and capricious standard is whether a reasonable person, considering the matter on the agency's table, could arrive at the judgment the agency made); Celcom Communications Corp. v. FCC, 789 F.2d 67, 71 (D.C. Cir. 1986)(remand for FCC failure to articulate ruling with sufficient clarity or specificity to permit meaningful review).

The USF Order's decision to commit to nonexistent FLEC models, while rejecting every FLEC model presently before the Commission, cannot pass muster under this standard. Under what definition of "rationality" can an agency adopt a regulatory model that will vitally affect the quality and affordability of telecommunications service in thousands of rural communities when: (a) it has no articulated idea as to what such a mechanism will look like, USF Order para. 252; and (b) when the evidence before it runs counter to the conclusion that the mechanism will work. At rock bottom, it simply makes no sense to endanger one of the central pillars of the 1996 Act with dangerous FLEC proxy model experiments. Such an

approach is not rational under the Administrative Procedure Act. 5 U.S.C. § 706, and should be reconsidered.

B. The Commission's Use of a Nationwide Revenue Benchmark Should be Reconsidered

The USF Order adopted a nationwide average revenue benchmark -- that is, one dominated by the higher per-customer revenues in urban and suburban areas -- as a means to reduce the Universal Service support received by rural carriers. USF Order paras. 259-267. The Commission defended its choice of a nationwide benchmark on the basis of its purported ease of administration, and because it allegedly will encourage the introduction of a new services in rural areas. Id. para. 263.

The predominantly urban/suburban benchmark is nothing more than a blatant device to cut the Universal Service support furnished to rural telephone companies. There is nothing in Section 254(b)(5) or elsewhere in Section 254 which contemplates that the Universal Service support of rural telephone companies may or should be reduced to account for revenues higher than they receive. The Commission's cavalier suggestion that this higher benchmark should give rural telephone companies an "incentive" to offer "new services" not only admits that their current revenues are well below its national benchmark but signals an apparent lack of concern for these rural carriers and their customers. The adoption of this nationwide revenue benchmark violates the "sufficiency" requirements of Sections 254(b)(5) and 254(e), and should be reconsidered.

C. The Commission's Decision to Fund Only 25 Percent of Its Universal Service Mechanism is Unlawful

The Commission's decision to fund only 25 percent of the Universal Service mechanism is patently unlawful and should be reconsidered for at least three reasons. First, the decision to fund only 25 percent of the federal Universal Service support mechanism amounts to a separations rewrite that was not subjected to Joint Board review under section 410(c) of the Communications Act. 47 U.S.C. § 410(c). Second, the Commission has improperly burdened

the states with funding 75 percent of the federal Universal Service support mechanism, contrary to the plain terms of Section 254 of the 1996 Act. Third, the decision clearly violates Section 254's requirement of sufficiency and predictability. These points are discussed in order.

Improper Separations Change. The Universal Service funding mechanism is inextricably linked to separations. This is clear both from the history of the mechanism itself, and from the 1996 Act. For instance, the current USF is a direct result of the Commission's 1984 decision to transition from a frozen Subscriber Plant Factor (SPF) to a flat 25 percent loop cost allocator. Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Decision and Order, 96 FCC 2d 781 (1984). In making this separations change, the Commission specifically recognized that its policy to lower interstate loop cost allocation factors would jeopardize affordable local rates, hence the necessity for a Universal Service mechanism. Id. at 791-802. Indeed, the Commission rejected arguments by MCI that the mechanism constituted an improper subsidy, noting the inherent difficulty in apportioning commonly-used non-traffic sensitive plant and expenses. Id. at 789. Thus, the current Universal Service support mechanism has its roots in jurisdictional separations, a mechanism that can be traced back to the Supreme Court's ruling that interstate operations cannot receive a free-ride for the use of the local exchange network. See Smith v. Illinois Bell Tel. Co., 282 U.S. 133 (1930).

In the 1996 Act, Congress obviously recognized this connection, by requiring the referral to a Joint Board under Section 410(c) -- the statutory section that is mandatory for separations changes -- of the proceeding to consider modification of federal Universal Service support mechanisms. See 47 U.S.C. § 254(a)(1). The Commission's decision to fund only 25 percent of the federal mechanism constitutes an unlawful separations change, contrary both to Section 254 and Section 410(c). For instance, the Commission acted without any Joint Board recommendation on the subject, Indeed, the USF Order is silent as to the Joint Board's thoughts on the matter. USF Order paras. 268 - 272. The Commission simply injected the

issue without any Joint Board referral, and such action constitutes an improper separations change.

Statutory Intent. The Commission's decision to burden the states with 75 percent of the federal mechanism also contravenes the plain language of Section 254(a), which mandates "federal universal service support mechanisms." There is no basis whatsoever in the 1996 Act or its legislative history for the Commission to slash federal Universal Service support by 75 percent, and to hand the states this 75 percent portion of an unfunded federal mandate. There is no reported Congressional support for such an approach, particularly given the fact that Section 254 was designed as a safeguard to counter the effects of other 1996 Act and Commission policy decisions.

Sufficiency and Predictability. The decision to fund only 25 percent of the federal mechanism violates the requirement that the federal program be both "sufficient" and "predictable."[8] That federal funding will not be "sufficient" can be seen by the drastic 75 percent reduction in funding provided under the current programs. For instance, 100 percent of loop costs which are defined as "high cost" are funded today. See 47 C.F.R. 36.601 - 641. The USF Order's optimism that the states will make up the 75 percent shortfall, USF Order para. 271, is wishful thinking. This same flawed dependence upon state funding renders the Commission's program wholly unpredictable. Indeed, in the Commission's sua sponte Order on Reconsideration in this proceeding, Federal-State Joint Board on Universal Service, CC Docket 96-45, Order on Reconsideration, FCC 97-246 (Rel. July 10, 1997), it is reduced to stressing the need for a "federal-state partnership" to "allay concerns" that the Commission's new mechanism will be insufficient. Id. para. 28. This is hardly a predictable Universal Service support mechanism.

Finally, the Commission's action will undermine its conclusion that local rates are

[8] 47 U.S.C. § 254(b)(5). It is noteworthy that section 254(b)(5) recognizes the development of state Universal Service support mechanisms in stating that they, too, should be "sufficient" and "predictable."